

JOHN F. KERRY, MASSACHUSETTS, CHAIRMAN
CHRISTOPHER S. BOND, MISSOURI, RANKING MEMBER

CARL LEVIN, MICHIGAN
TOM HARKIN, IOWA
JOSEPH I. LIEBERMAN, CONNECTICUT
PAUL D. WELLSTONE, MINNESOTA
MAX CLELAND, GEORGIA
MARY LANDRIEU, LOUISIANA
JOHN EDWARDS, NORTH CAROLINA
MARIA CANTWELL, WASHINGTON
JEAN CARNAHAN, MISSOURI

CONRAD BURNS, MONTANA
ROBERT F. BENNETT, UTAH
OLYMPIA J. SNOWE, MAINE
MICHAEL ENZI, WYOMING
PETER G. FITZGERALD, ILLINOIS
MIKE CRAPO, IDAHO
GEORGE ALLEN, VIRGINIA
JOHN ENSIGN, NEVADA

United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

WASHINGTON, DC 20510-6350

PATRICIA R. FORBES, MAJORITY STAFF DIRECTOR AND CHIEF COUNSEL
EMILIA DISANTO, REPUBLICAN STAFF DIRECTOR

November 4, 2002

The Honorable Charles O. Rossotti
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Commissioner Rossotti:

The Treasury Inspector General for Tax Administration (TIGTA) recently issued a report on the Internal Revenue Service's (IRS) implementation of the new suspension of interest provisions under section 6404(g) of the Internal Revenue Code (Code). TIGTA's findings raise several troubling issues that warrant your agency's prompt attention.

As TIGTA notes in the report entitled, "The New Suspension of Interest Provision Is Not Always Calculated Correctly" (Reference Number: 2002-10-187), the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) added section 6404(g) to the Code because "interest and penalties can quickly increase a tax debt to the point that it becomes virtually impossible for the average taxpayer to satisfy the unpaid tax liabilities" For many small businesses, such interest and penalties can mean the difference between satisfying their tax liability and the death of the enterprise. Accordingly, this new provision stops interest and penalties from accumulating unless the IRS notifies the taxpayer that additional taxes are due within 18 months of the timely filing of the taxpayer's return.

As a strong proponent of this taxpayer protection, I am troubled by TIGTA's estimate that out of a sample of 43,220 tax returns for 1998 with additional tax assessments, 10,506 taxpayers (24%) had incorrect or missing notification dates listed in their accounts. As the report points out, without this information, the IRS' "computer programming would not be able to recognize that the additional assessment qualified for the suspension of interest and would not suspend interest as required by law." Even more troubling, however, is TIGTA's projection that out of those 10,506 taxpayers, 8,651 cases (82%) resulted in an over- or under-assessment of interest all because of the misapplication of section 6404(g) of the Code.

For the 1998 returns that TIGTA sampled alone, the over-assessed interest amounted to \$536,280 and the under-assessed interest totaled \$120,585. In light of these figures, I am pleased to see that you will implement systematic reminders to IRS personnel and quality review procedures to ensure that the interest-suspension provision is properly applied to taxpayer accounts. In addition, I urge you to identify the taxpayers who have been over- or under-assessed interest in these cases, and if the statute of limitations permits, provide appropriate refunds or abatelements.

In addition to the notification-date mistakes, TIGTA also found that certain computer-programming errors and omissions are preventing this provision from being applied in a timely fashion to help taxpayers as Congress envisioned. In particular, I note that the IRS' current computer programming charges taxpayers with an additional day of interest before the suspension period begins. Additionally, the report points out that the IRS has failed to suspend interest for taxpayers who have part or all of their Earned Income Tax Credit (EITC) disallowed. TIGTA estimates this failure resulted in nearly 2,000 low-income taxpayers being overcharged more than \$25,000 in interest in 1998 alone.

While I applaud the agency's recognition that the law has been incorrectly applied in this regard, I am concerned that the necessary computer-programming changes will not become operational until January 1, 2004. This taxpayer protection was intended to help taxpayers beginning with their 1998 tax returns. It is difficult to understand why it will take nearly six years to apply it correctly. Moreover, it is unclear in the agency's response whether the corrective action will apply only to taxpayers with disallowed EITC amounts after 2003 or whether the corrective action will also be applied retroactively. I urge you to give all taxpayers faced with disallowed EITC amounts the full protection that Congress intended.

Finally, TIGTA noted that for certain 1998 tax returns, the IRS incorrectly suspended interest and penalties due to a computer-programming discrepancy. While the agency detected and corrected this error in July 2001, it led to a troubling anomaly: the under-assessment could spring back to life if the taxpayer's account is updated with additional activity in the future. One such instance of "additional activity" is disaster relief for fires, floods, hurricanes, and the terrorist attacks of September 11, 2001.

TIGTA estimates that approximately 28,728 taxpayers were under-assessed \$1.6 million in interest as a result of this situation. In addition, TIGTA projects that at least 2,123 of these taxpayers qualified for disaster relief and were subject to approximately \$324,842 in interest because of the programming anomaly. For the remaining 26,605, the under-assessment of interest could spring back to life with the next disaster and increase their tax bill when they least expect or can afford it. I also understand that certain tax provisions applicable to the nation's military personnel could constitute "additional activity" and trigger the dormant interest.

In light of the potentially devastating effects of this computer-programming anomaly, I applaud the statement in the agency's October 15, 2002, response to the TIGTA report to "identify taxpayers with under-assessed interest and abate the under-assessed amounts to prevent burden on future disaster relief taxpayers or other taxpayers in special military conditions." Given the turbulent natural and political conditions in recent times, I urge you to implement this corrective action as quickly as possible.

As the Ranking Member of the Senate Committee on Small Business and Entrepreneurship, I understand the difficulties that the IRS faces in keeping up with the changes made to our current tax system. If we are to expect America's taxpayers to comply with that system, however, it is imperative that it is applied fairly and consistently to all taxpayers.

Thank you for looking into this matter. I appreciate your willingness to address the notification-date and computer-programming issues noted in the TIGTA report and to institute procedures to ensure that interest and penalties are suspended on taxpayers accounts in accordance with the law. If you have any questions or would like to discuss this matter in greater detail, please do not hesitate to contact me or have your staff contact Mark Warren, the Committee's Tax Counsel, at 202/224-4086.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Bond", written in a cursive style.

Christopher S. Bond
Ranking Member

cc: Mr. John Reece
Deputy Commissioner for Modernization
and Chief Information Officer

Mr. Joseph Kehoe
Commissioner, Small Business/Self-Employed Division